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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

BOB STUMP, Chairman
GARY PIERCE
BRENDA BURNS
BOB BURNS
SUSAN BITTER SMITH

IN THE MATTER OF THE APPLICATION OF
ARIZONA PUBLIC SERVICE COMPANY FOR A
HEARING TO DETERMINE THE FAIR VALUE OF
THE UTILITY PROPERTY OF THE COMPANY
FOR RATEMAKING PURPOSES, TO FIX A JUST
AND REASONABLE RATE OF RETURN
THEREON, TO APPROVE RATE SCHEDULES
DESIGNED TO DEVELOP SUCH RETURN.

Docket No. E-01345A-11-0224

**NOTICE OF FILING
SURREBUTTAL TESTIMONY
OF ARIZONA INVESTMENT
COUNCIL**

Pursuant to the requirements of the Procedural Order dated March 25, 2014 in this matter,
attached is the Surrebuttal Testimony of Gary Yaquinto on behalf of the Arizona Investment
Council. Your assistance is appreciated.

RESPECTFULLY SUBMITTED this 21st day of July, 2014.

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Surrebuttal Testimony

of Gary Yaquinto

on Behalf of

Arizona Investment Council

July 21, 2014

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I. INTRODUCTION

Q. Mr. Yaquinto, did you previously file Direct Testimony on AIC's behalf in support of Arizona Public Service Company's ("APS" or the "Company") request for a Four Corners Rate Rider?

A. Yes, I did. I pointed out that APS' Application in this Docket was consistent with the provisions of Section X of the Settlement Agreement agreed to by the parties and authorized by the Commission in the Company's last rate case decision, No. 73183 (the "Decision"). I also stressed the importance of Commission approval of this Four Corners Rate Rider. The Commission's Staff and RUCO supported this process and the Joint Signatories to the Settlement Agreement identified it as a "material" factor in order for "APS to remain financially healthy for customers to benefit from high quality service and for APS to achieve Arizona's energy goals."¹

Q. Please restate what the Commission authorized APS to seek in this filing.

A. In approving the Settlement Agreement, the Commission held open the rate case:

[F]or the sole purpose of allowing APS...to file an application with the Commission seeking to reflect in rates the rate base and expense effects associated with the acquisition of SCE's share of [the Four Corners] Units 4 and 5, the rate base and expense effects associated with Units 1-3 and any cost deferral authorized in Docket No. E-01345A-10-0474.

In summary, the Commission authorized this process to (1) strengthen rate stability in support of another Settlement Agreement term, i.e., "a four year rate case stay out, in

¹ Decision, p. 31, l. 24-p. 32, l. 5.

1 which APS agreed not to raise base rates as a result of any...filing prior to July 1, 2016";²
2 (2) minimize regulatory lag; and (3) expedite timely recovery of costs. To accomplish
3 each of those goals, the AIC urges the Commission to approve the Company's
4 Application and requests.

5
6 **II. RESPONSE TO SIERRA CLUB, UTILITIES DIVISION STAFF**
7 **AND RUCO TESTIMONIES**

8 **Q. Have you reviewed Mr. Hausman's Direct Testimony on behalf of the Sierra Club?**

9 A. Yes, I have. Mr. Hausman disputes the "benefits to ratepayers from the [Four Corners]
10 acquisition relative to other resource options...." He recommends the Commission deny
11 APS' request and re-file a more detailed analysis.

12
13 **Q. What is AIC's response?**

14 A. Given the Sierra Club's opposition to coal-fired generating resources in general, I was not
15 surprised it would oppose APS' acquisition of Southern California Edison's interests in
16 the coal-fired Four Corners plant. As for his analysis, AIC did not perform its own
17 economic analysis of the transaction, so I cannot comment directly on the merits of
18 Mr. Hausman's review.

19
20 I note, however, Company witness James Wilde's discussion on this subject. In his
21 rebuttal testimony, he states that Sierra Club criticisms of the ratepayer benefits which
22 will flow from the transaction are unfounded and points out that ACC Staff's Consultant

23 ² Decision, p. 10.

1 agrees the Four Corners acquisition does, in fact, provide significant benefits to
2 customers:

3 The inputs used and analysis performed by APS...support a
4 conclusion by this Commission that this Transaction provides
5 significant benefits to Arizona customers...just as Staff's
6 consultant also concluded.³

6 **Q. Did you review the rebuttal testimonies of Messrs. Guldner and Snook and**
7 **Ms. Blankenship on APS' updated revenue requirements calculation of \$65.44**
8 **million, as well as their responses to the Staff and RUCO positions that revenue**
9 **requirements should be reduced by \$8.39 million and \$16.24 million, respectively?**

10 A. Yes, I have reviewed the APS testimonies and the testimonies of Staff and RUCO.

11
12 **Q. Do you have any comments on the revenue requirement positions of the respective**
13 **parties?**

14 A. Yes. APS' methodology for calculating the revenue requirement utilizes the proper rate
15 base and rate of return components reflected in the Commission's instructions in
16 Decisions No. 73130 and 73183 in arriving at the \$65.44 revenue requirement.

17
18 However, both the Staff and RUCO approaches depart from the ratemaking treatment
19 contemplated in Decision No. 73183, although in different ways.

20
21
22
23 ³ Wilde Rebuttal, p. 6, ll. 14-17.

1 **Q. Please explain the differences and why Staff and RUCO have used incorrect**
2 **methods to arrive at their estimates of revenue requirement.**

3 A. Decision No. 73130, regarding the accounting treatment of cost deferrals related to APS'
4 acquisition, specifies that "the documented debt cost of acquiring SCE's interest in
5 Units 4 and 5"⁴ be used in calculating the deferrals. APS correctly utilized the cost of
6 debt of 4.725 percent in calculating the deferral component of the revenue requirement.
7 Both Staff and RUCO agree with the deferral amounts and the cost of debt used in
8 calculating the amount of deferred costs, so there is no dispute on this component of the
9 revenue requirement.

10
11 However, both Staff and RUCO use incorrect methods to calculate the rate base treatment
12 of Units 4 and 5 as contemplated in Decision No. 73183. In doing so, both RUCO and
13 Staff fail to apply proper ratemaking concepts to arrive at a fair value rate of return on
14 rate base, which includes Units 4 and 5.

15
16 APS witness Snook, in his rebuttal testimony, provides the mathematical basis for
17 calculating the proper return on the Units 4 and 5 assets in his critique of the analyses
18 performed by Staff and RUCO. Mr. Snook correctly calculates the return as if the
19 addition of Units 4 and 5 was part of the original rate case, which was, in fact, held open
20 in Decision No. 73183 for the express purpose of rate-basing these assets once the
21 transaction was completed. As Mr. Snook points out, the weighted cost of capital of
22 8.33 percent found in Decision 73183 is the correct value to apply to Units 4 and 5's

23 ⁴ Decision No. 73130, p. 37, ll. 8-9.

1 original cost rate base, just as it was utilized in the rate case for the Company's total
2 original cost rate base.

3
4 In contrast, the Staff analysis simply applies the fair value rate of return of 6.09 percent
5 determined in Decision No. 73183 to the original cost rate base value of Units 4 and 5.
6 This is incorrect, because the fair value rate of return used by Staff reflects a blended rate,
7 which combines the weighted cost of capital of 8.33 percent on OCRB with the much
8 lower return rate of 1 percent on the "incremental fair value rate base," which is a proxy
9 measure of the replacement value for the assets to arrive at FVROR.
10

11 **Q. In APS' calculation of the revenue requirement, did it include an incremental fair**
12 **value rate base component?**

13 A. No. According to Mr. Snook's testimony, APS' revenue requirement was calculated
14 without a value ascribed to incremental fair value rate base.
15

16 **Q. If APS had included the incremental fair value rate base component coupled with a**
17 **1 percent return attached to it, what would be the revenue requirement?**

18 A. Based on the estimated value of RCND in Mr. Snook's testimony, it would have added
19 approximately \$4 million more to the revenue requirement.
20

21 **Q. Did Staff's calculation of revenue requirement include a consideration of**
22 **incremental fair value of the Units 4 and 5 assets?**

23 A. No.

1 **Q. Turning to RUCO's position, is its application of the marginal cost of debt to**
2 **determine the revenue requirement for rate basing Units 4 and 5 appropriate?**

3 A. No. RUCO's use of the marginal cost of debt in calculating the revenue requirement for
4 Units 4 and 5 is a misinterpretation of Decision No. 73183 and results in an egregious
5 misuse of proper ratemaking methods. RUCO mistakes a directive from an accounting
6 order related to cost deferrals in Decision No. 73130 as a reason to preclude the Company
7 from earning the return on its investment to which it's entitled in the rate case.

8
9 As I stated previously in my testimony, Decision No. 73183 was kept open for the
10 express purpose of including the costs related to APS' acquisition of SCE's share of Four
11 Corners Units 4 and 5. Accordingly, these assets should be included in rate base as if
12 they were part of that original rate case. This means the same weighted cost of capital for
13 Units 4 and 5 should be used as was applied in the rate case for the Company's total
14 original cost rate base.

15
16 **III. CONCLUSION**

17 **Q. Mr. Yaquinto, do you have a recommendation for the Commission?**

18 A. Yes. I recommend the Commission approve APS' request as presented for the Four
19 Corners Rate Rider.

20
21 **Q. Does this conclude your testimony?**

22 A. Yes, it does.
23